STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

RE: Examination Report of Missouri Employers Mutual Insurance Company for the period ended December 31, 2010

ORDER

After full consideration and review of the report of the financial examination of Missouri Employers Mutual Insurance Company for the period ended December 31, 2010, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, John M. Huff, Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo., adopt such examination report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo: summary of significant findings, subsequent events, company history, corporate records, management and control, fidelity bond and other insurance, pension, stock ownership and insurance plans, territory and plan of operations, growth of the company and loss experience, reinsurance, accounts and records, statutory deposits, financial statements, financial statement changes resulting from examination, and comments on financial statement items.

Based on such findings and conclusions, I hereby ORDER, that the report of the Financial Examination of Missouri Employers Mutual Insurance Company as of December 31, 2010, be and is hereby ADOPTED as filed and for Missouri Employers Mutual Insurance Company to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement, and verify compliance with each item, if any, mentioned in the Comments on Financial Statement Items and/or Summary of Recommendations section of such report; (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this 20th day of June, 2012.

John M. Huff, Director
Department of Insurance, Financial Institutions and Professional Registration

REPORT OF THE

ASSOCIATION FINANCIAL EXAMINATION OF

MISSOURI EMPLOYERS MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

FILED
JUN 30 2012
DIRECTOR OF INSURANCE, FINANCIAL INSTITUTIONS & PROFESSIONAL REGISTRATION

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STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

TABLE OF CONTENTS

Columbia, Missouri
May 11, 2012

Honorable John M. Huff, Director
Missouri Department of Insurance, Financial Institutions
and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65101

Director Huff:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Missouri Employers Mutual Insurance Company

hereinafter referred to as MEM or the Company. Its administrative office is located at 101 North Keene Street, Columbia, Missouri, 65201, telephone number (573) 499-9714. The examination began on July 12, 2011, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of MEM was made as of December 31, 2007, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with no other zones participating.

The current full scope association financial examination covered the period from January 1, 2008, through December 31, 2010, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating.

The examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook, except where practices, procedures and applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration (DIFP) and statutes of the State of Missouri prevailed. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about corporate governance, identifying and assessing inherent risks, and evaluating the Company's controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The key activities identified in our examination of MEM were as follows:

- Investments
- Premiums
- Underwriting
- Claims Handling
- Reserving
- Reinsurance
- Related Party Transactions
- Expenses and Compensation

The examiners relied upon information supplied by the Company's independent auditor, BKD, LLP, of Kansas City, Missouri, for its audit covering the period from January 1, 2010 through December 31, 2010. Areas in which the testing and results from the CPA workpapers were relied upon in our examination included reviews of internal controls, bank confirmations, paid claims data, premiums receivable, unearned premiums, attorney representation letters, fraud assessment, and subsequent events review.

SUMMARY OF SIGNIFICANT FINDINGS

1) The Company's incentive plan for 2010 was structured with financial targets and goals that were too easily attainable and were well below the financial results achieved in prior years. The Company failed to develop any incentive plan for 2011, but still made significant incentive payments to executives and non-executives. Management's evaluation of 2011 financial results to justify the payment of incentives was flawed due to the use of performance measures that overstated MEM's achievements. As a result, there was no correlation between MEM's declining financial results in 2010 and 2011 and the level of incentives paid to executives and non-executives in both years. The annual incentive payments for MEM employees and executives appear to have become more of an additional salary component rather than a reward that is dependent upon achievements on an individual and/or Company-wide level.

2) The Company's profit sharing contributions to employee's 401(k) savings plans are not based upon a reasonable measurement of MEM's financial results. MEM made yearly contributions during 2008 to 2011 to the 401(k) plans of its employees that were equal to 5% of each employee's annual salary, which was in addition to the 50% matching contribution that was already provided. The profit sharing contributions are not tied to the level of an employee's contribution, resulting in situations of the Company's contribution being much higher than the amount contributed by the employee. The profit sharing contributions also appear to be redundant with the significant incentive payments that are paid by MEM.

3) Some of the Company's expenditures for business travel, entertainment and gifts during 2008 to 2011 appeared to be excessive for a mutual insurance entity. The use of limousine service for ground transportation, first class airfare, large travel expenses for spouses, payments for expensive recreational amenities, and cash gifts were noted in the examination period. There were also instances of travel expenditures that were less related to a business purpose, but appeared to be more personal in nature.

SUBSEQUENT EVENTS

Effective January 1, 2011, MEM acquired United Security Insurance Company (USI) from QBE Holdings, Inc. Refer to the Mergers and Acquisitions section of this report for further details.

Criminal charges were filed against members of the MEM's Board of Directors and executive management during 2011 and 2012 for individuals that served on the Board or were employed, as of December 31, 2010, and prior periods. This included the resignation of Director Douglas Morgan in May 2011 after he was indicted by a federal grand jury in April 2011 under charges of bank fraud for providing false information to obtain \$3.6 million in bank loans. Mr. Morgan was indicted again in June 2011 under charges of wire fraud for soliciting and obtaining \$1.5 million for a casino development. President and Chief Executive Officer Roger Wilson was placed on indefinite administrative leave in May 2011 and ultimately terminated in June 2011. Mr. Wilson was indicted by a federal grand jury in April 2012 and subsequently pled guilty to charges of misappropriating \$5,000 of MEM's funds. A former Director, Karen Pletz, resigned from MEM's Board in December 2009 and was later indicted by a federal grand jury in March 2011 under charges of embezzling \$1.5 million from her employer.

Several bills regarding MEM were filed in the 2012 session of the Missouri Legislature that remain pending as of the date of this report. Much of the legislation is aimed at privatizing the Company by repealing the original statutes enacted in 1993 that formed MEM and creating a successor company. The privatization of MEM would remove the Governor of Missouri's appointment of members that serve on MEM's Board of Directors and eliminate its federal tax exempt status. Other bills could require a contribution of a portion of MEM's capital and surplus to the State of Missouri, depending upon future studies that would be completed in 2012. If legislation is enacted, significant impacts on MEM's organizational structure and financial condition could occur. It should be noted that any legislative changes significantly impacting the structure or capital and surplus of MEM may result in dramatically effecting the viability and sustainability of the Company's operations in the future.

COMPANY HISTORY

General

MEM was created pursuant to Sections 287.900 to 287.920 of the Revised Statutes of Missouri (RSMo), which is referred to as the "Missouri Employers Mutual Insurance Company Act." Section 287.920(5) RSMo specifies that the Company is "subject to all provisions of the statutes which relate to private insurance carriers." In compliance with this statute, MEM operates under the statutes in Chapter 379 RSMo (Insurance Other Than Life) for property and casualty insurers.

The Company was created for the purpose of insuring Missouri employers against liability for workers' compensation, occupational disease, and employers' liability coverage. The laws creating MEM were enacted in 1993. The Company was subsequently organized on September 16, 1994 and commenced business on March 1, 1995. The initial Board of Directors were appointed by the Governor of the State of Missouri. The initial capitalization of MEM was from $5 million received from the State of Missouri, as consideration for a surplus note that was issued in 1995. The note and all accrued interest was repaid on September 16, 1999. MEM was granted tax-exempt status by the Internal Revenue Service, as of December 1, 1998.

The Company was organized and operates as a domestic mutual insurance company, but it is not an agency of the State of Missouri. However, the Company's Bylaws require that three of the five directors serving on the Board of Directors shall be appointed by the Governor of Missouri, subsequent to election by the policyholders. The Bylaws state that if the Governor rejects a director candidate, the policyholders must elect a new director candidate to be submitted to the Governor for appointment.

Capital Stock

The Company was organized as a mutual entity and therefore, does not have any capital stock ownership. The Company is owned 100% by its policyholders.

Dividends and Capital Contributions

MEM did not pay any cash dividends to its policyholders during the examination period. However, the Company did accrue a liability of $2 million in its 2011 Annual Statement for dividends to be paid to policyholders in 2012. This will represent the first payment of dividends to policyholders in the Company's history.

MEM made a cash contribution of $500,000 to USI in August 2011 for the stated purpose of increasing USI's capital and surplus above $5,000,000, which is a required minimum level necessary to maintain USI's license to operate in several states.

Mergers and Acquisitions

MEM entered into a Stock Purchase Agreement on July 22, 2010 to acquire United Security Insurance Company (USI) from General Casualty Company of Wisconsin. The closing date for the purchase was effective January 1, 2011, with a final purchase price of $7,186,886. The purpose of the USI acquisition was to provide a better vehicle to write business for current and future policyholders with employees in states other than Missouri. The Company currently has a fronting arrangement with Argonaut Insurance Company for out-of-state risks, which is explained in the Reinsurance Assumed section of this report. MEM plans to begin writing the out-of-state risks of its Missouri policyholders through USI on January 1, 2013.

MEM entered into a Voting Trust Agreement with USI and Commerce Bank, N.A. that was effective on the same date (January 1, 2011) that USI was acquired. This Agreement transferred the Company's ownership of USI common stock to Commerce Bank, N.A., which holds the stock as a voting trustee under the terms of the Agreement. A three member independent panel was also established to advise Commerce Bank, N.A. on any recommended actions to be voted with the USI shares. Thus, USI is not legally an affiliate of MEM under the laws of Chapter 382 RSMo (Insurance Holding Companies) because of the trustee arrangement. However, USI functions as a subsidiary of MEM with common management, employees and business operations that are structured to compliment MEM's business plan.

CORPORATE RECORDS

A review was made of the Articles of Incorporation and Bylaws for the examination period. There were no amendments or changes to the Articles of Incorporation either during or subsequent to the period under examination. The Bylaws were amended and restated in December 2010 to (1) add further requirements for the submission to the Governor of Missouri for approval of elected directors, (2) clarify the powers and duties of elected directors that are pending Governor approval, and (3) validate any actions of an elected director that was rejected by the Governor. The Bylaws were amended and restated again in February 2012 to eliminate the article allowing for the issuance of revenue bonds and to make several other minor changes.

The minutes of the Board of Directors' meetings, policyholder's meetings, and committee meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

MANAGEMENT AND CONTROL

Corporate Governance

The management of the Company is vested in a Board of Directors, which are elected by the policyholders. The Company's Bylaws specify that the Board of Directors shall consist of five directors. The Board of Directors appointed and serving, as of December 31, 2010, were as follows:

Name	Address	Principal Occupation and Business Affiliation
Douglas D. Morgan [1]	Chesterfield, MO	Retired (deceased November 9, 2011)
James J. Jura*	Springfield, MO	Chief Exec. Officer, Associated Electric Cooperative
James C. Owen* [2]	Columbia, MO	President and Chief Executive Officer, MEM
Judith S. Heeter*	Mission Hills, KS	Senior Partner, Polsinelli Shugart, P.C.
Gary B. O'Neal	Chesterfield, MO	Chief Executive Officer, Commercial Bank

* Appointed by the Governor of Missouri

[1] Mr. Morgan resigned on May 31, 2011 and was replaced by Charles A. Caisley, effective August 4, 2011.

[2] Mr. Owen resigned on December 21, 2011 to become the permanent President and CEO of MEM. His former position on the Board remained vacant, as of the date of this report.

Interviews with members of executive management and the Board of Directors were conducted as part of the review and assessment of corporate governance in our examination. The following issues were disclosed during the interviews: instances of fraudulent use of MEM funds, improper expenditures, lack of controls over expense reports, and excessive incentive compensation. Management disclosed the federal investigation of Roger Wilson regarding the misappropriation of MEM funds, which was an amount that was not material to the financial condition of the Company and was being fully reviewed by the appropriate authorities.

Our examination placed an emphasis on reviewing expenses and compensation in response to the information provided in the interviews. Refer to the Incentive Compensation, Profit Sharing, and the Travel, Entertainment and Other Expenses sections of this report for a summary of our examination findings for these areas.

Committees

The Bylaws require the Board of Directors to have a Nominating Committee and allow for the creation of other committees, if authorized by resolution. In addition to the Nominating Committee, the following committees of the Board of Directors were established, as of December 31, 2010: Audit Committee, Investment Committee, and Compensation Committee. All directors also serve on each of the committees.

Officers

The officers elected by the Board of Directors and serving, as of December 31, 2010, were as follows:

Officer	Position
Roger B. Wilson [3]	President and Chief Executive Officer
Doug S. Phillips	Vice President of Finance, Chief Financial Officer, Treasurer
Tim D. Jackman	Vice President of Risk Mgmt. and Legal Services, Secretary

[3] Mr. Wilson was placed on administrative leave on May 13, 2011 and terminated on June 30, 2011. Mr. Owen served as interim President and CEO from May 13, 2011 until being elected permanent President and CEO by the Board of Directors on December 21, 2011.

The Company also had the following non-elected members of senior management, as of December 31, 2010:

Name	Position
Mike Foerst [4]	Vice President of Information Services (IS)
Michael Kravchick	Vice President of Sales and Marketing
Steve Millikan [5]	Vice President of Public Affairs
Joyce Underwood	Vice President of Policyholder Services
Mike Berry [6]	Assistant Vice President of Corporate Finance and Treasury
Chris Geering	Assistant Vice President of Actuarial and Operational Analysis
Annelle Whitt [6]	Assistant Vice President of Claims
Barry Kelly	Director of Sales
Cassandra Rashman [6]	Director of IS Applications, Development & Support
Shann Sievers	Director of Human Resources
Bob Steinmetz [4]	Director of IS Applications, Development & Support
Melissa Woodall	Controller

[4] Mr. Foerst resigned in November 2011 and was replaced by Mr. Steinmetz

[5] Mr. Millikan retired in March 2012

[6] Positions held by Mr. Berry, Ms. Whitt, and Ms. Rashman were eliminated in October 2011

Holding Company, Subsidiaries and Affiliates

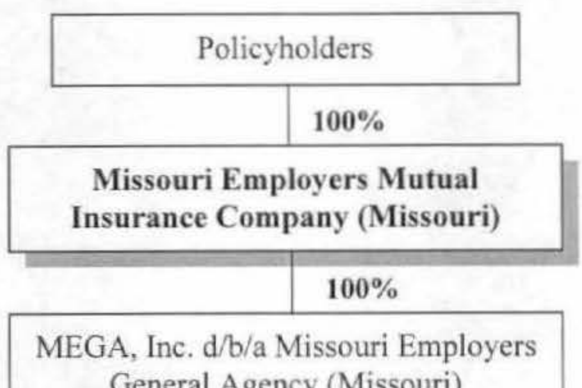
The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by MEM for each year of the examination period. MEM does not have any stockholders or a controlling entity due to its formation as a mutual insurer. The Company is ultimately controlled by its policyholders, which elect the Board of Directors. As explained previously, a majority of directors elected by the policyholders are subject to approval by the Governor of Missouri.

The only other entity in the holding company system, as of December 31, 2010, was MEM's subsidiary, MEGA, Inc., d/b/a Missouri Employers General Agency (MEGA). MEGA was previously utilized as the licensed agent for MEM risks insured outside of the State of Missouri through a fronting arrangement with unaffiliated ceding companies. MEGA's services were no longer needed when MEM contracted with a new ceding company, Argonaut Insurance Company, at the end of 2003. MEGA has been a shell entity with no active operations since the end of 2005. Management does not currently have any plans to liquidate MEGA in the event that a new business use could develop in the future.

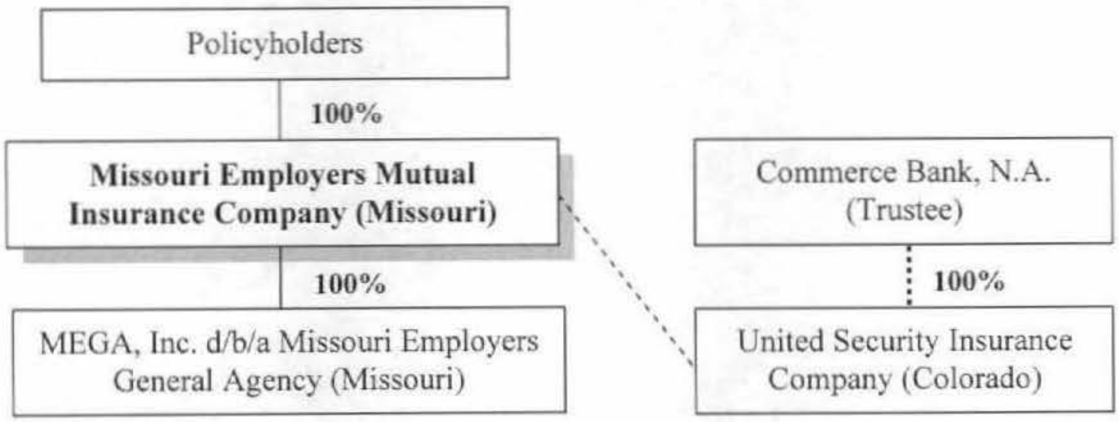
United Security Insurance Company is a Colorado domiciled insurer that was acquired by MEM, effective January 1, 2011. USI is not technically a subsidiary of MEM under Missouri Holding Company laws due to the unique voting trust structure that was implemented, as explained in the Mergers and Acquisitions section of this report. USI is licensed in 18 states, but had no written premiums in 2011 and no premium writings are planned until January 1, 2013. All policy liabilities for business written by USI, prior to MEM's acquisition in 2011, was ceded 100% to the previous owner of USI through a loss portfolio transfer agreement.

Organizational Chart

Below is the organizational chart of MEM and its affiliates, as of December 31, 2010.



Below is the organizational chart of MEM and its affiliates, as of January 1, 2011, which reflects the addition of USI.



········· Controls voting rights in USI stock through a revocable trust agreement

------- Beneficial owner of USI stock

Intercompany Agreements

The Company did not have any active agreements with related parties, as of December 31, 2010. MEM has a General Operating Agreement with MEGA, effective February 1, 2001, in which MEGA will serve as a general agent for the Company to produce and issue policies for the employers that have employees working outside of the State of Missouri. However, there have been no transactions under this agreement since 2005.

The Company executed several agreements with USI that were all effective January 3, 2011 and are described below:

1) Administrative Services Agreement – MEM will provide the following services for USI: product development, marketing, producer contracting, regulatory and compliance, customer service, human resources, accounting, financial reporting, tax preparation, legal, billing, rate development, and other services.
2) Claims Adjudication Agreement – MEM will provide the following services for USI: data entry, claim processing, claim investigations, governmental filings, reserve determination, claim settlement, management of litigated claims, and other services.
3) Loss Control Services Agreement – MEM will provide the following services for USI: policyholder surveys for underwriting, accident investigations, workplace safety programs, safety training for policyholders, and other services.
4) Premium Consultation Agreement – MEM will provide the following services for USI: conduct audits of policyholder payroll exposures or classifications, conduct new business consultations, and manage audit disputes.
5) Services Agreement – USI will provide the following services for MEM: management of sales and marketing, strategic planning, agency travel, sales reports, legal research, and other services.

6) Underwriting Agreement – MEM will provide the following services for USI: establish underwriting rules, analyze and underwrite policy applications, provide premium quotes, maintain applications and other policy records, manage policy endorsements or other policy changes, re-underwrite renewal policies, process non-renewals and cancellations, and prepare policy forms.

FIDELITY BOND AND OTHER INSURANCE

The Company has a financial institution bond to cover losses resulting from fraudulent or dishonest acts of an employee. The bond has a liability limit of $1,000,000 with a $50,000 deductible, which meets the minimum coverage that is recommended by the NAIC. The Company is also covered by the following other insurance policies: commercial property, commercial general liability, commercial excess and umbrella liability, electronic data processing equipment, business auto, employment liability, directors' and officers' liabilit y, insurance services professional liability, employed lawyers' professional liability, kidnapping and extortion, worker's compensation, employer's liability, and cyber security.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2011, the Company had 143 employees located in its home office in Columbia, Missouri. Another 57 employees were located in the branch offices in Kansas City, St. Louis, and Springfield, Missouri.

A variety of standard benefits are provided to the employees. These benefits include the following insurance plans: medical, dental, vision, life, and disability. Other benefits include vacation, sick leave, flexible spending accounts (cafeteria plan), health club benefits, tuition reimbursement, adoption assistance, dependent scholarships, and a 401(k) savings plan. The Company matches 100% of employee contributions to the 401(k) savings plan up to 1% of the employee's salary and matches 50% of employee contributions up to the next 5% of the employee's salary. A profit sharing component of the 401(k) plan is described below.

Additional standard benefits for executives (Vice President level and above) include a Company car, family health club memberships, and executive physicals.

Incentive Compensation

MEM provides an incentive compensation plan for all of its employees. The structure of incentive payments differs between executives and non-executives. Incentives for executives were historically (2009 and prior) based upon fixed percentage of profits, while non-executives generally receive an incentive that is based upon a fixed percentage of annual salary.

The Company's incentive compensation plans have changed significantly both during and subsequent to the examination period. Below is a description of the different plans in use since 2007:

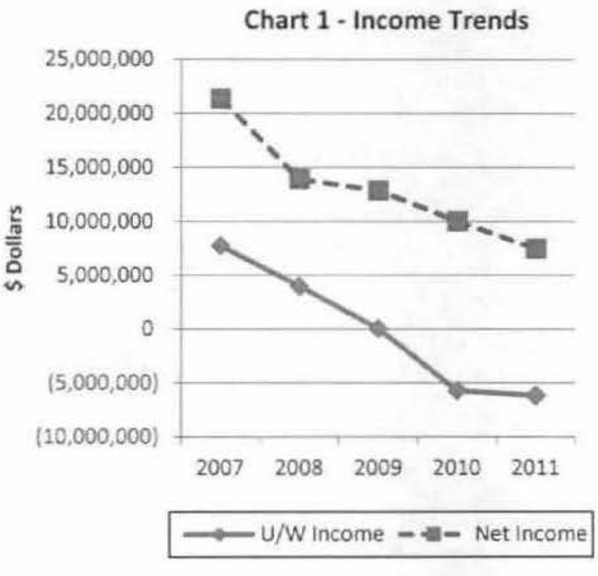
- **Plan Years 2007 through 2009** – Incentives were based upon the profitability of MEM's operations. Any annual profits in excess of a 7% return on equity (GAAP basis surplus) were used to establish funds available to pay incentives. A maximum of 35% of the amount of net income exceeding the 7% threshold was established as a pool of funds for incentive payments. Executive incentives were based upon a defined percentage of the available pool of incentive funds, which varied among executive levels. Non-executive incentives were calculated as a fixed percentage of an employee's annual salary, which also varied depending on the pay grade of each employee.
- **Plan Year 2010** – The incentive plan was changed to a three-tiered formula of premium growth, combined ratio, and return on net premiums. The Board of Directors approved targets for each of the three categories at the beginning of the year. Financial results were used to determine the actual performance in comparison to the targeted goals. The Company's calculations determined that actual results achieved 103% of the targets for the year. Defined percentages of annual salary for both executives and non-executives were used to calculate the 2010 incentive payouts and were increased an extra 3% for achieving more that the targeted goals for the three financial performance categories.
- **Plan Year 2011** – Management and the Board of Directors did not establish any incentive plan for the year. Rather, at the end of 2011, management hired a compensation consulting firm to determine the average incentives paid to a group of fifteen insurers that were deemed to be of similar size to MEM. Incentives were paid to employees at defined percentages of annual salary depending on pay grade so that the total payments did not exceed the averages of the comparable insurer group.

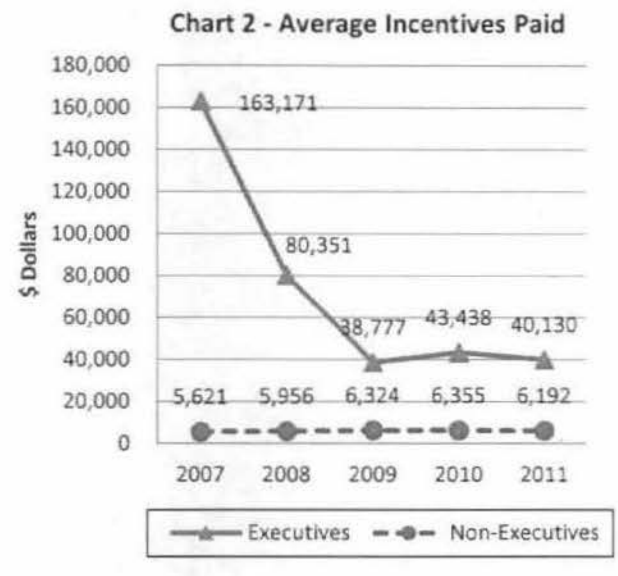
MEM usually pays incentives in the first quarter following each plan year. For example, incentives for the 2011 plan year were paid to employees in March 2012. The table below summarizes the Company's incentive payments over the last 5 years.

	EXECUTIVES				NON-EXECUTIVES			
Plan Year	Incentives Paid	Emp. Count	Average Incentive	% of Salary	Incentives Paid	Emp. Count	Average Incentive	% of Salary
2007	$3,100,257	19	$163,171	108%	$1,264,788	225	$5,621	10%
2008	1,285,615	16	80,351	49%	1,191,237	200	5,956	10%
2009	542,882	14	38,777	26%	1,207,829	191	6,324	10%
2010	651,572	15	43,438	28%	1,201,051	189	6,355	10%
[1] 2011	561,818	14	40,130	27%	1,046,459	169	6,192	10%

[1] No incentives were paid for the President and CEO position for 2011

Although there have been changes to the structure of the various incentive plans used by MEM, overall there has been little variability in the average incentives payments over the last 5 years. The charts below show that net income and underwriting income have steadily decreased each year over the five year period from 2007 through 2011, but only executive incentives for 2008 and 2009 reflected decreases to correspond with the decreases in MEM's financial results.





Executive incentives were not negatively affected by lower net income in 2010 and 2011, but were affected in 2008 and 2009. Incentive payments for non-executive employees have been totally immune from large decreases in net income by receiving incentives that average 10% of their annual salaries for each year from 2007 to 2011. MEM's business has suffered from the weak economy since 2008, but this has had little to no effect upon the level of incentives paid to most employees.

The incentives paid for the 2010 and 2011 plan years would have been drastically different if the Company would have used the same formula that was in effect for the 2007 to 2009 plan years. Total incentives for 2010 would have been only about $925,000 using the 2007-2009 formula, instead of the $1.9 million that was actually paid under the 2010 incentive plan formula. There would have been zero incentives paid in 2011 under the 2007-2009 formula, instead of the $1.6 million that was actually paid that year.

The financial targets in the 2010 incentive plan appeared to have been structured to be easily attainable to match the trending decreases in profitability that had occurred in prior years. For example, the Company achieved a combined ratio (claims and operating expenses as a percentage of premiums) of 99.3% in 2009, but set a much worse combined ratio of 104.5% as a target to achieve for the incentive plan. Actual underwriting results decreased from break even in 2009 to a loss of $5.7 million in 2010, which resulted in a lower combined ratio of 101.9% for 2010. However, due to the structure of the incentive plan formula, the underwriting loss in 2010 actually exceeded a much larger loss that was targeted as a goal, which resulted in higher

incentives paid to employees. The budgets and financial targets were much easier to achieve or exceed when low expectations were included in management's projections.

The failure to a establish any incentive plan for 2011 was apparently due to the inability of the Company's management and Board of Directors to structure an incentive plan that could be agreed upon before the year had already been completed. The $1.6 million in incentive payments that employees were rewarded should more properly be characterized as discretionary bonuses. A compensation consultant hired by MEM management recommended that 2011 incentives should be based upon MEM's 2011 financial performance, using factors such as performance against the budget, improvement over prior years (combined ratio, surplus, premium growth), and performance relative to the market (such as combined ratio). However, the amount of 2011 incentive payments were based upon average payments of other insurers and not based upon MEM's actual financial results.

Management provided an analysis to justify the 2011 incentives that were paid, but there were flaws in the statistics that were presented. One positive result was explained to be that MEM achieved a 104.0% combined ratio in comparison to the target 2011 combined ratio of 108.8%, as stated in the 2011 to 2013 Strategic Plan approved by the Board of Directors. This was a poor target in comparison to the actual 2010 combined ratio of 101.9% (as explained for the 2010 incentive payments above). As was the case for 2010, MEM's goal for the 2011 combined ratio was easily achievable since the targeted ratio was set with such low expectations. Management also touted a 4.5% growth in premiums as an achievement in 2011. However, a large portion of the growth was artificial due to a change in the reinsurance coverage, which resulted in lower ceded premiums and higher net premiums. The number of MEM policyholders actually decreased by 1.7% in 2011.

Profit Sharing

MEM has historically made "profit sharing" contributions to the 401(k) plans of its employees every year. The profit sharing contributions are in addition to the normal matching of the employees' contribution to their 401(k) plans. MEM matches 100% of an employee's 401(k) contributions for the first 1% of salary and matches 50% of employee's contributions for the next 5% of salary. The profit sharing contribution was equal to 5% of each non-executive employee's annual salary for years 2009 and prior and 4.5% of each non-executive employee's annual salary for years 2010 and later. The 0.5% decrease in profit sharing in 2010 was offset by a corresponding 0.5% increase in the MEM's matching contribution. Executives receive an additional profit sharing contribution equal to 4.5% of salary in excess of $106,800.

Below is a summary of the Company's contributions and employee contributions to 401(k) plans for 2008 to 2011:

Year	Employee Contributions	MEM Contributions			MEM % Contribution
		Matching	Profit Sharing	Total	
2008	$1,352,663	$474,542	$953,485	$1,428,027	106%
2009	1,245,949	426,586	888,316	1,314,902	106%
2010	1,262,389	504,882	769,645	1,274,527	101%
2011	1,299,254	511,267	770,995	1,282,262	99%

When the Company's 401(k) matching contribution is combined with the 401(k) profit sharing contribution, the total MEM contribution can be up to 125% of the amount contributed by the employee (for employees contributing the maximum 6% of salary) and even higher for executives. A 2010 U.S. Bureau of Labor Statistics report refers to generous 401(k) plans, in which an employer contributes up to 100% of an employee's contribution, as a "Cadillac" plan. MEM is contributing at a rate even higher than such "Cadillac" plans.

MEM's profit sharing contribution is not dependent upon the level of contribution by the employee. An employee can contribute as little as 1% of their salary to the 401(k) plan, and still receive a profit sharing contribution of 5% of their annual salary. This leads to unusual situations in which the employee contributes very little to their 401(k) plan, but receives a much larger contribution from MEM. For example, there was one employee with a salary of $130,000 per year that only contributed $1,250 to her 401(k) plan in 2010. However, MEM made a 100% matching contribution and a $6,923 profit sharing contribution for a total contribution of $8,173 for this employee. In this example, MEM's total contribution to the employee's 401(k) plan was equal to 654% of the employee's contribution.

The Board of Directors passed a resolution in December 2010 requiring that MEM achieve net income of $4 million per year in order to make the full amount of profit sharing payments. Decreasing amounts are to be paid with net income between $1 million and $4 million. These net income levels are very low compared to MEM's historical results. Since 1998, MEM has averaged net income of $12 million and only one year (2001) did not achieve net income of $4 million. MEM would have to experience one of the largest underwriting losses for any year in its history in order to not make the profit sharing payments to employees' 401(k) plans. The contributions have not been structured so that the amount of profit sharing is impacted by realistic variations in the Company's financial results. The profit sharing contributions also appear duplicative of the incentive payments that are already provided as employee benefits.

TERRITORY AND PLAN OF OPERATION

MEM is licensed as a property and casualty insurer by the Missouri DIFP under Chapter 379 RSMo (Insurance Other than Life). The Company is not licensed in any other states. However, the Company does have a fronting arrangement to assume risks of MEM policyholders that have employees located outside of the State of Missouri. A further description of this arrangement is included in the Reinsurance section of this report.

The Company's only line of business is workers' compensation, as prescribed by the statutes in the Missouri Employers Mutual Insurance Company Act, which created MEM in 1994. MEM is the market share leader for workers' compensation insurance in Missouri with a 16.1% share of 2010 direct written premiums. Approximately 1,000 independent insurance agencies are used to produce the Company's business. The top 100 agencies produced 71% of MEM's total earned premiums for 2010.

Section 287.902 RSMo (Missouri Employers Mutual Insurance Company) requires that the Company shall give preference to Missouri employers with an annual premium of $10,000 or less. As of December 31, 2010, 83% of MEM's policyholders had annual premiums of $10,000 or less.

GROWTH OF COMPANY

The table below shows the Company's premium writings and writing ratios for the most recent five years, which includes the current examination period.

Year	Direct Premiums Written	Net Premiums Written	Change in Net Premiums	Capital and Surplus	Ratio of Net Premiums to Surplus
2007	$141,502,329	$137,379,748	na	$133,485,517	1.03
2008	129,016,868	126,783,215	-7.7%	134,723,008	0.94
2009	110,134,841	107,394,164	-15.3%	154,350,400	0.70
2010	109,669,993	108,140,704	0.7%	163,097,276	0.66
2011	138,736,211	139,893,952	29.4%	167,699,533	0.83

The large decreases in premiums written in 2008 and 2009 were attributable to higher unemployment in Missouri. The loss of jobs resulted in large decreases in the total amount of Missouri payroll, which is the basis for worker's compensation premiums. The large increase in premiums written in 2011 is attributable to a change in accounting method, effective January 1, 2011. Premiums written are recorded based upon the effective date of the policy beginning in 2011 instead of the policy bill date, which was the accounting method prior to 2011.

The large increase in capital and surplus in 2009 was due to a $15 million improvement in capital gains on investments from 2008 to 2009. The capital and surplus increases in 2010 and 2011 are largely due to net investment income in excess of $6 million of underwriting losses in both years.

LOSS EXPERIENCE

The table below shows the Company's incurred losses and loss ratios for the most recent five years, which includes the current examination period.

Year	Net Premiums Earned	Net Losses and Loss Adjustment Expenses Incurred	Loss Ratio
2007	$135,809,374	$82,591,949	60.8%
2008	128,871,923	79,381,303	61.6%
2009	109,910,114	71,030,005	64.6%
2010	107,790,424	78,325,014	72.7%
2011	112,684,442	82,306,610	73.0%

The increase in the loss ratio that has occurred each year since 2007 is due partly to inflation in medical costs for injured employees of policyholders and partly due to premium decreases that have been necessary to maintain market position.

REINSURANCE

General

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	2008	2009	2010
Direct Business	$129,016,868	$110,134,841	$109,669,993
Reinsurance Assumed – Affiliates	0	0	0
Reinsurance Assumed – Non-affiliates	5,030,086	3,803,323	4,644,711
Reinsurance Ceded – Affiliates	0	0	0
Reinsurance Ceded – Non-affiliates	(7,263,739)	(6,544,000)	(6,174,000)
Net Premiums Written	$126,783,215	$107,394,164	$108,140,704

Assumed

All of the assumed business during the examination period was from Argonaut Insurance Company (Argonaut). MEM has some policyholders that have employees located outside of the State of Missouri. The Company is only licensed to write business in Missouri and therefore, a fronting arrangement with Argonaut has been necessary to insure the out-of-state risks. Argonaut is the direct writer for these out-of-state risks and MEM assumes 100% of the business, pursuant to a reinsurance agreement with Argonaut, effective January 1, 2010.

Ceded

The Company's reinsurance program consists primarily of excess of loss coverage and multi-layer catastrophe coverages. Separate reinsurance coverage is obtained for terrorism risks and aircraft risks. New reinsurance agreements are executed each year for all coverages on a calendar year basis.

Below is a summary of MEM's reinsurance coverages as of December 31, 2010:

Coverage Layer	Retention per Occurrence	Reinsurance Limit Excess of Retention	Aggregate Limit of Reinsurance
Excess of Loss	$ 1,500,000	$ 5,500,000	$ 12,000,000
1st Layer Catastrophe	7,000,000	16,000,000	32,000,000*
2nd Layer Catastrophe	23,000,000	27,000,000	54,000,000*
3rd Layer Catastrophe	50,000,000	50,000,000	100,000,000*
Industrial Aid (Aircraft)	500,000	5,000,000	10,000,000*

* with payment of reinstatement premium

The Company's reinsurance program for 2008 to 2010 had mostly the same retentions and coverages that were in effect for the prior examination date, as of December 31, 2007. The only change was an increase to the primary excess of loss retention from $1,000,000 to $1,500,000 in 2008. There were significant changes to the reinsurance program, effective January 1, 2011. An aggregate deductible of $1,500,000 was added to the 2011 excess of loss coverage, which reduced the aggregate limit of reinsurance from $12,000,000 to $10,500,000 for this primary layer. The 3rd layer catastrophe coverage was also eliminated in 2011. The amount of MEM's losses per occurrence that are covered by reinsurance is currently limited to a maximum of $50,000,000 in comparison to $100,000,000 for the 2010 program year.

The Company utilizes various authorized and unauthorized reinsurers to cede risks. There were approximately 27 participating reinsurers in the 2010 reinsurance program and no reinsurer assumed more than 15% of total ceded premiums. The following four reinsurers, National Union Fire Insurance Company of Pittsburgh, Swiss Reinsurance America Corporation, Hannover Ruckversicherungs AG, and MAX Bermuda Ltd., collectively accounted for 70% of total ceded loss reserves, as of December 31, 2010. National Union Fire Insurance Company of Pittsburgh had the largest amount of ceded reserves from MEM at December 31, 2010, but has not participated in MEM's reinsurance agreements since the 2004 loss year. The long-tailed nature of the Company's workers' compensation business is responsible for the slow development of the loss reserves for prior years.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

ACCOUNTS AND RECORDS

General

The Company's data center is located in the home office in Columbia, Missouri. The computer hardware in the data center has an Intel central processing unit (CPU) with Hewlett-Packard and Dell servers. The operating systems are a combination of Microsoft Windows and RedHat Linux servers. A wide area network uses Cisco routers to connect the branch offices in Kansas City, St. Louis and Springfield to the data center through a cloud system that has a live connection to the disaster recovery provider, SunGard.

Various software applications are used for the MEM's business processes. Investments transactions and accounting are outsourced to a third party, Conning Asset Management, which uses its Conning Asset Management Reporting and Accounting (CAMRA) application. Claims management uses the Guidewire ClaimCenter program. Policy and billing management software was replaced in 2011 and now use the Guidewire PolicyCenter and BillingCenter applications. Financial reporting is performed with Oracle Financial software.

The CPA firm, BKD, LLP, of Columbia, Missouri issued audited 2010 statutory financial statements of the Company. The 2008 and 2009 audited financial statements were issued by the CPA firm, Swink, Fiehler & Company, PC, of St. Louis, Missouri.

The actuarial opinion regarding the Company's reserves for losses and loss adjustment expenses was issued by John Herzfeld, FCAS, MAAA, of Milliman, Inc. in Wakefield, Massachusetts, for all years of the examination period.

Travel, Entertainment and Other Expenses

The Company did not have adequate written policies and procedures for the authorization and reimbursement of employee travel, entertainment, and other expenses. A review of employee travel expense reports and general expenses showed payments for several items that appeared to be an excessive amount for a mutual insurance entity and/or there was a questionable business purpose. Below are examples of expenditures found in the review:

- **Transportation:** July 2008 – An executive was reimbursed for $619 of limousine charges incurred in a single day for round trip transportation to a Pro-Am golf tournament in Bethpage, New York. August 2008 – MEM paid for $12,127 of transportation costs over a three day period for 21 individuals attending a Board of Directors retreat in Park City, Utah. September 2009 – MEM paid approximately $4,000 for limousine transportation to restaurants during a Board of Directors retreat.
- **Entertainment / Personal Expenses:** August 2008 – Spa charges of $5,148 were paid for attendees and spouses at the Board of Directors retreat in Park City, Utah. December 2008 – MEM paid $400 for an executive's membership in the American Airlines Admirals Club. September 2009 – Rental of a suite, food and beverages totaling $7,405 at a Chicago Cubs game for executives and the Board of Directors.

- **Hotel Room Rates:** May 2009 – An executive was reimbursed $1,434 for two nights lodging and meals at Tucker's Point resort in Bermuda with an average daily room rate of $653 per night. September 2009 – A Board of Directors retreat was held in Chicago for 16 MEM directors, executives and other employees with an average room rate of $444 per night.
- **First Class Airfare:** April 2009 – First class flights for an executive, two directors and their spouses to Cabo San Lucas, Mexico for a President's Trip at a total cost of $11,740 or nearly $2,000 per person. February 2010 – First class flights for a director and spouse to Maui, Hawaii for a President's Trip at a total cost of $7,978 or nearly $4,000 per person. [Note: The annual President's Trip is meant to benefit the agencies that produce the top ten amounts of premium volume.]
- **Meals:** August 2008 – A catered dinner for 30 individuals at the Board retreat in Park City, Utah at a cost of $4,800 for an average cost of $160 per person. September 2009 – A catered dinner for 23 individuals at the Board retreat in Chicago, Illinois at a cost of $5,278 for an average cost of $229 per person.
- **Spousal Travel Expenses:** Numerous instances were noted in which airfare, meals, and other expenses (such as golf outings and registration fees) were paid for the spouses that accompanied executives and non-executives during President's Trips. At least $40,000 was spent on airfare for spouses of executives and directors during 2008 to 2011.
- **Gifts:** December 2011 - $50 bills were distributed to all 200 MEM employees (including executives) at the holiday luncheon at a cost of $10,000.
- **Other:** 2008 to 2011 – Two MEM employees made site visits in advance of the annual President's Trip to scout the venues and amenities at costs of approximately $2,000 per year. The Company already utilizes a travel agency to coordinate the plans for the President's Trip. January to October 2008 – An executive was reimbursed for $16,400 in relocation expenses for a move from St. Louis, Missouri to Columbia, Missouri. This included reimbursement for $6,110 for closing costs on the executive's new home in Columbia, $9,425 for seven months rental in a corporate apartment, plus meals and lodging for his family during "house hunting" and moving trips.
- **Fraudulent Payments:** October 2009 – A political contribution of $5,000 was illegally made with the use of MEM funds. The payment was channeled as a legal expense through a St. Louis law firm and approved by former President and CEO, Roger Wilson. Other events associated with this misappropriation of MEM funds are described in the Subsequent Events section of this report.

It was noted during our review that the majority of excessive and questionable expenses occurred in 2008 and 2009. In addition, none of the expenses detailed above were material to the Company's financial condition. The level of expenses for the above categories decreased noticeably in 2010 and 2011. Management stated that MEM will no longer conduct any Board of Directors functions outside of the State of Missouri.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri DIFP as of December 31, 2010, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities to be Deposited). The funds on deposit were as follows:

Type of Security	Par Value	Fair Value	Book Value
U.S. Treasury Note	$1,300,000	$1,331,538	$1,302,683

Other Deposits

The Company has assets in two bank accounts that have been pledged as collateral for letters of credit (LOCs) issued by MEM to ceding companies, pursuant to reinsurance agreements. The funds on deposit, as of December 31, 2010, for the two collateral accounts were as follows:

LOC Beneficiary	Type of Pledged Security	Par Value	Fair Value	Book Value
Argonaut Insurance Company	Corporate Bonds and Money Market Funds	$16,497,093	$17,671,066	$16,678,509
American Alternative Insurance Corporation	Money Market Funds	$ 1,233,445	$ 1,233,445	$ 1,233,445

The Company also has funds on deposit with the U.S. Department of Labor, as required by the Longshore and Harbor Workers' Compensation Act. The deposit allows MEM to insure certain workers covered by this Act, including those on navigatable waters. The funds on deposit with the U.S. Department of Labor, as of December 31, 2010, were as follows:

Type of Security	Par Value	Fair Value	Book Value
U.S. Treasury Note	$500,000	$522,345	$503,857

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Missouri Employers Mutual Insurance Company for the period ending December 31, 2010. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the Comments on Financial Statement Items. The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the Comments on Financial Statement Items section. These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each key activity.

Assets
as of December 31, 2010

	Assets	Non-Admitted Assets	Net Admitted Assets
Bonds	$284,545,527	$ 0	$284,545,527
Preferred Stocks	14,933	0	14,933
Common Stocks	27,743,623	0	27,743,623
Real Estate (Occupied by Company)	15,945,942	0	15,945,942
Cash, Cash Equivalents and Short-Term Investments	22,423,856	0	22,423,856
Receivables for Securities	28,669	0	28,669
Investment Income Due and Accrued	3,157,113	0	3,157,113
Uncollected Premiums and Agents' Balances	8,792,043	1,623,893	7,168,150
Deferred Premiums (Earned but Unbilled)	635,038	63,504	571,534
Amounts Recoverable from Reinsurers	1,853,000	0	1,853,000
EDP Equipment and Software	2,482,116	2,385,361	96,755
Furniture and Equipment	717,475	717,475	0
Aggregate Write-In Assets	8,907,184	8,456,354	450,830
TOTAL ASSETS	$377,246,519	$13,246,587	$363,999,932

Liabilities, Surplus and Other Funds
as of December 31, 2010

Losses	$144,288,997
Reinsurance Payable on Paid Losses and LAE	175,871
Loss Adjustment Expenses	13,844,000
Commissions Payable	1,331,199
Other Expenses	6,706,464
Taxes, Licenses and Fees	639,074
Unearned Premium	23,212,319
Advance Premium	2,361,742
Ceded Reinsurance Premiums Payable	765,597
Amounts Withheld or Retained	7,429,165
Provision for Reinsurance	91,000
Payable to Parent, Subsidiaries and Affiliates	39,698
Aggregate Write-In Liabilities	17,530
TOTAL LIABILITIES	**$200,902,656**
Surplus Notes	20,035,438
Unassigned Funds (Surplus)	143,061,838
Capital and Surplus	**$163,097,276**
TOTAL LIABILITIES AND SURPLUS	**$363,999,932**

Statement of Income
For the Year Ended December 31, 2010

Premium Earned	$107,790,424
DEDUCTIONS:	
Losses Incurred	66,859,815
Loss Adjustment Expenses Incurred	11,465,199
Other Underwriting Expenses Incurred	35,167,358
Total Underwriting Deductions	$113,492,372
Net Underwriting Loss	($ 5,701,948)
Net Investment Income Earned	14,322,727
Net Realized Capital Gains	2,109,130
Net Investment Gain	$ 16,431,857
Other Income	(686,912)
Dividends to Policyholders	0
Federal Income Taxes Incurred	0
Net Income	$ 10,042,997
CAPITAL AND SURPLUS ACCOUNT:	
Surplus as Regards Policyholders, December 31, 2009	$154,350,400
Net Income	10,042,997
Change in Net Unrealized Capital Gains or (Losses)	3,713,954
Change in Non-Admitted Assets	(4,919,070)
Change in Provision for Reinsurance	(91,000)
Change in Surplus Notes	(60)
Aggregate Write-In for Gains and Losses in Surplus	55
Surplus as Regards Policyholders, December 31, 2010	$163,097,276

Comments on Financial Statement Items

None.

Examination Changes

None.

General Comments and/or Recommendations

Incentive Compensation (pages 10-13)

The management and Board of Directors of MEM should structure future incentive compensation plans to more closely align the incentives paid to employees with the Company's profitability each year. Incentive payments should be less reliant upon the achievement of targets and goals for any year that has low financial expectations, such as occurred in 2010. The incentive plan should establish minimum thresholds of underwriting income and net income that need to be achieved before any incentives can be paid, such as the formula used for the 2007 to 2009 incentive plan y ears. Finally, the comparison of MEM's incentive payments to peer companies or industry averages should be used to establish maximum levels of incentive payouts for the various salary grades and not as the sole determining factor with which to base the incentive payouts, as occurred in 2011.

Profit Sharing Contributions (pages 13-14)

The management and Board of Directors of MEM should consider eliminating the profit sharing contributions that are made annually to the 401(k) savings plans of its employees. Any additional compensation above the employees' annual salary should already be accomplished with the payments under the incentive plan. If profit sharing continues to be a component of 401(k) contributions, management and the Board of Directors should strive to achieve an overall contribution level (matching plus profit sharing) that is more in line with the average contribution rates for the insurance industry. Limits should be instituted on an individual basis to prevent an employee from receiving profit sharing contributions that are disproportionately much higher than the employee's own contributions.

Travel, Entertainment and Other Expenses (pages 18-19)

Although the level of expenses related to travel, entertainment and other expenses decreased noticeable in 2010 and 2011 as a result of new internal controls and policies, the management and Board of Directors of MEM should ensure policies and procedures are adequate to ensure reasonable expenses for business travel. This would include the use of first class airfare, the use of limousine service, daily maximums for hotel room rates, daily maximums for meals, and acceptable amenities and entertainment expenses that are included in the annual President's Trip. In light of MEM's tax exempt status, management should consider eliminating or curtailing the level of expenses for the following items: (1) advance site visits by MEM employees to scout locations for the annual President's Trip, (2) the payment of travel and entertainment expenses for spouses during any MEM functions, (3) employee relocation and moving expenses, (4) cash gifts or gift certificates provided to employees.

The management and Board of Directors of MEM should also continue to implement policies and procedures to ensure all expenses including those of top executives are legal and in accordance with MEM's internal policies.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Missouri Employers Mutual Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Barbara Bartlett, CFE, Scott Rennick, AFE, and Timothy Carroll, examiners for the Missouri DIFP, participated in this examination. Jon Michelson, FCAS, MAAA, of Expert Actuarial Services, LLC, also participated as a consulting actuary.

VERIFICATION

State of Missouri)
)
County of)

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Missouri Employers Mutual Insurance Company its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim L. Tunks

Tim L. Tunks, CPA, CFE
Examiner-In-Charge
Missouri DIFP

Sworn to and subscribed before me this 14th day of May, 2012.

My commission expires: ______________ Sheila M Burgess
Notary Public

SHEILA M. BURGESS
Notary Public - Notary Seal
State of Missouri
Commissioned for Boone County
My Commission Expires: November 02, 2012
Commission Number: 08408885

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Mark A. Nance

Mark A. Nance, CPA, CFE
Audit Manager
Missouri DIFP

Missouri Employers Mutual

June 18, 2012

Via e-mail and Certified Mail – Return Receipt Requested

Frederick G. Heese
DIFP, Division of Insurance Company Regulation
301 West High Street, Room 530
P.O. Box 690
Jefferson City, MO 65102

Re: Examination Report of Missouri Employers Mutual Insurance Company

Dear Mr. Heese:

Thank you for your correspondence dated May 18, 2012, including the Examination Report of Missouri Employers Mutual Insurance Company for the period ending December 31, 2012 (the "Report").

Please find enclosed our Company's response to the Report included with your letter. We ask that this response be included with the Report as a public document.

Please let me know if you have any questions or comments.

Sincerely,

James C. Owen
President and CEO

Encl. - 1

c: Tammy Rodieck, Exam Coordinator (w/Encl. via e-mail)

Missouri Employers Mutual Insurance Company (NAIC #10191)
Company Response – Examination Report dated May 18, 2012

SUBSEQUENT EVENTS (page 3)

Company Response: MEM wishes to clarify that the criminal indictments of two members of MEM's Board of Directors were unrelated to MEM or other MEM personnel and had no financial impact to MEM. As to the guilty plea of Roger Wilson for misappropriating $5,000 of MEM funds, such activity was discovered and reported by MEM, Mr. Wilson was terminated from employment as a result, and the funds are in the process of being reimbursed as part of his plea agreement. The new Board of Directors and leadership have strengthened governance policies to ensure that MEM has strong internal controls and acts in accordance with best practices.

Further, as to the bills filed in the 2012 session of the Missouri Legislature, none were passed.

General Comments and/or Recommendations

Incentive Compensation (pages 10-13)

The management and Board of Directors of MEM should structure future incentive compensation plans to more closely align the incentives paid to employees with the Company's profitability each year. Incentive payments should be less reliant upon the achievement of targets and goals for any year that has low financial expectations, such as occurred in 2010. The incentive plan should establish minimum thresholds of underwriting income and net income that need to be achieved before any incentives can be paid, such as the formula used for the 2007 to 2009 incentive plan years. Finally, the comparison of MEM's incentive payments to peer companies or industry averages should be used to establish maximum levels of incentive payouts for the various salary grades and not as the sole determining factor with which to base the incentive payouts, as occurred in 2011.

Company Response: We agree that the incentives paid to employees should closely align with the Company's profitability, but also believe that other factors are important for consideration so as not to encourage or reward profitability above all other objectives of an independent public mutual insurance company. For example, MEM has decreased rates for five consecutive years, the available premium in the market decreased by $63 million in 2010 over 2009, and MEM issued a $2 million dollar dividend for the first time in 2011 – all of which negatively impacted profitability. MEM's incentive plan reflects the market reality in which we operate, including the decision to lower rates.

Because the Company performed favorably against the market and out-performed its projections in spite of strategic decisions that negatively affected profitability, the Board of Directors determined that incentive payments to reward and retain its talent were warranted for 2010 and 2011. Working closely with Mercer, a nationally-recognized compensation consultant, to

evaluate and benchmark incentive plan objectives and payout levels against the market, the Company remains committed to evaluating its compensation structure to ensure that it is market-based and incentivizes results that best serve the long-term interests of our policyholders.

Profit Sharing Contributions (pages 13-14)

The management and Board of Directors of MEM should consider eliminating the profit sharing contributions that are made annually to the 401(k) savings plans of its employees. Any additional compensation above the employees' annual salary should already be accomplished with the payments under the incentive plan. If profit-sharing continues to be a component of 401(k) contributions, management and the Board of Directors should strive to achieve an overall contribution level (matching plus profit sharing) that is more in line with the average contribution rates for the insurance industry. Limits should be instituted on an individual basis to prevent an employee from receiving profit sharing contributions that are disproportionately much higher than the employee's own contributions.

Company Response: MEM respectfully disagrees with this finding. MEM's 401(k) match and profit-sharing plan are retirement benefits, not performance incentives. As MEM does not offer a pension plan, these are the only retirement benefits offered for employees. They have been in place since 1995 and never have been questioned by any auditor or examiner.

Rather than incentivizing performance, these benefits are structured to reward employee longevity and savings. Employees vest in the 401(k) employer match and profit sharing contribution after two years of employment. The 401(k) employer match is based on a standard formula based on employee deferrals (100% match of the first 1% deferred by employee; 50% match of next 5% deferred by employee), while profit-sharing is a discretionary contribution by the company based on net income, the maximum contribution being 5% of an employee's salary. The fact that the net income guideline provides flexibility for the Company to avoid paying a contribution under circumstances where the financial results of the company make such a contribution inappropriate does not change the nature of the contribution from a retirement benefit into incentive compensation.

MEM conducts periodic reviews of its benefits package, the most recent of which indicates that the Company is in the 25th percentile of the market with respect to its retirement benefits.

Travel, Entertainment and Other Expenses (pages 18-19)

Although the level of expenses related to travel, entertainment and other expenses decreased noticeably in 2010 and 2011 as a result of new internal controls and policies, the management and Board of Directors of MEM should ensure policies and procedures are adequate to ensure reasonable expenses for business travel. This would include the use of first class airfare, the use of limousine service, daily maximums for hotel room rates, daily maximums for meals, and acceptable amenities and entertainment expenses that are included in the annual President's Trip. In light of MEM's tax exempt status, management should consider eliminating or curtailing the

level of expenses for the following items: (1) advance site visits by MEM employees to scout locations for the annual President's Trip, (2) the payment of travel and entertainment expenses for spouses during any MEM functions, (3) employee relocation and moving expenses, (4) cash gifts or gift certificates provided to employees.

The management and Board of Directors of MEM should also continue to implement policies and procedures to ensure all expenses including those of top executives are legal and in accordance with MEM's internal policies.

Company Response: While we note that the expenses mentioned are not material to MEM's financial condition, the Company agrees to periodically review its policies and procedures to ensure appropriate consideration of the Department's concerns regarding travel and other expenses. Under new leadership, the Company has instituted revised policies and procedures, including a revised Corporate Travel and Expense Reimbursement Policy which was implemented in June 2012.